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The myth of economic globalization
Notes from a European perspective

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The myth of economic globalization

Notes from a European perspective

by

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Abstract:

Patterns of commodity trade and foreign direct investment are not consistent with the proposition that European economies are experiencing a process of increasing 'globalization'. Internationalization takes place as economic integration within the European Union and the European Union apparently does not become more integrated with the World's other two trade blocs. Moreover, other than globalization theory might cause us to predict, the share in foreign direct investment taken by low-wage countries shows little growth. We try to explain such findings, using arguments about the nature of the process of technological change.

JEL-codes: F01, F02, F21, F40, O31

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I Introduction

In recent years, there has been a great deal of writing about an increasing 'mondialization' or 'globalization' of the World economy. Recent progress in information and communication technology and the internet hype have created the impression that geographic distance is losing significance for business. Moreover, the relatively successful industrialisation of several low wage Asiatic countries gave rise to concern that an increasing challenge from international competition might undermine employment and welfare in Europe.

In this context, it has frequently been argued that Europe is suffering from competitive disadvantages relating to such factors as too high (and downwardly rigid) wages, too much regulation ('Eurosclerosis'), a heavy social security tax burden and a too generous protection of the people by the welfare state, preventing an adequate working of the labour market. If correct, such arguments would have obvious and far-reaching implications for economic and social policy in the European Union.

Arguments about economic globalization very often are based on case studies and anecdotal evidence while little effort seems to have been taken to examine representative economic statistics. In section II we start with a look at standard statistical sources, arguing that patterns of foreign trade and of foreign direct investment of EU countries are *not* consistent with globalization theory. We conclude that internationalization takes place as economic integration within the EU bloc. Furthermore, to the extent that the frontiers of the European Union are exceeded, the lion's share of such transactions still takes place among the rich OECD countries. Moreover, one might question the proposition that we are currently experiencing an historically unique new stage of internationalization.

In our final section, we argue that there are good theoretical reasons to doubt the globalization hypothesis. In doing so, we refer to literature about the nature of technological knowledge and about technological spill-overs. We argue that, at least for knowledge-intensive business, the forces behind 'regionalization' (or even 'localisation') may be stronger than those promoting 'globalization' .

II Patterns of foreign trade and investment

a) Foreign trade

Are we experiencing a uniquely new stage of internationalization of the world economy? As a rough indicator of internationalization, Table 1 shows the sum of exports plus imports as a percentage of GNP of a number of advanced industrialized countries.

In 1973 exports and imports as a percentage of GNP in most countries were lower than in 1913. This was due to the fact that international trade had suffered from two World Wars and from increasing protectionism induced by the economic slowdown after 1929. Although world trade has been recovering since the 1950s, some countries in 1994 had not even reached the 1913 levels.

Table 1: Exports and imports of goods as a percentage of GNP (current prices) according to Maddison (199 1: 149)

	1913	1950	1973	1994
France	30.0	21.4	29.2	34.2
Germany	36.1	20.1	35.3	39.3
UK	47.2	37.1	37.6	41.8
Netherlands	(100)*	70.9	74.8	89.2
USA	11.2	6.9	10.8	17.8
Japan	30.	16.4	18.2	14.6

* The figure of 100% reported by Maddison has been called into question by Lindblad & Van Zanden (1989: 231-269). After a (rough) correction for Dutch transit trade, they suggest that the real figure should be around 60%.

Against this interpretation, one can argue that Table 1 understates the 'true' degree of internationalization since current ***prices*** are used. Sectors that are exposed to international competition usually have a stronger technological dynamism and show higher rates of productivity growth than 'sheltered' sectors that are oriented towards domestic markets. In the long run, the difference in technological performance between 'sheltered' and 'exposed' sectors will result in inflation rate differentials, implying that inflation rates of GNP tend to be higher than inflation rates of exports and imports. Hence, when using the ratio of exports to GNP at ***current*** prices, the degree of internationalization appears to be much lower than when using ***constant*** prices (Mensink & Van Bergeijk 1996: 914).

This would be a valid objection if we were to study economic growth over time (with an implicit emphasis on physical quantities). However, we are interested in the relative ***economic*** importance of domestic versus foreign transactions Inflation is not merely a monetary phenomenon and insofar as inflation rate differentials reflect 'real' factors such as market power or productivity growth differentials, prices ***actually*** *realised* give a more realistic impression of the relative importance of an economic activity. It is therefore questionable whether exports and GNP in Table 1 should be deflated, making it understandable that statistical agencies tend to report exports and imports as percentages of GNP in ***current*** prices.

While deflated series tend to show a much increased importance of foreign trade as a percentage of GNP (see Mensink & Van Bergeijk 1996: 194), the data in current prices (Table 1) show that the relative importance of foreign trade is at present not exceptionally high by historical standards. Nevertheless, exports and imports have gained importance since the 1950s even according to our Table 1. Does this prove that we are living in a stage of 'globalization'?

For a judgement about this we should examine where imports come from and where exports go to. Table 2 shows exports of EU countries (as a percentage of GDP) to other countries of the European Union, while Table 3 shows exports of EU countries to non-EU countries. It becomes obvious from Table 2 that trade among EU partners has strongly gained in importance since the 1960s, whereas the relative importance of exports to non-EU partners (Table 3) tended to stagnate. Table 3 shows that only a few EU countries increased trade (as a percentage of GDP) with non-EU partners; in most countries, the relevant percentages stagnated or even diminished. Figures on imports which can be found in the same source (European Commission 1996) show a similar pattern. Table 4 summarises exports and imports of the EU-12 countries with EU and non-EU countries and shows clearly that, for the average EU-12, intra-EU exports as a percentage of EU GDP more than doubled. The same holds for imports. Exports of the EU-12 to *non-*EU countries stagnated, while the percentage share in GDP of imports from non-EU countries even declined slightly.

In summary, the three tables show a clear trend towards 'Europeanization' of export and import relations over the past 35 years, while the relative importance of trade with non-EU partners has stagnated. In other words, the EU as a trade bloc does not seem to become more integrated with the World economy as suggested by globalization theorists. This implies that the increase in the overall importance of foreign trade since the 1960s (shown in Table 1) is to be ascribed to a process of 'regionahzation' (or European bloc formation) rather than to 'globalization'.

Table 2: Exports of goods by EU countries to other EU countries (as a percentage of GDP, current prices)

country of origin:	1960	1970	1980	1990	1995
Belgium/Luxembourg	19.6	34.3	39.6	45.7	43.9
Denmark	14.1	13.4	16.5	17.4	15.4
(West) Germany	6.4	11.0	14.3	16.9+	11.8#
Greece	2.1	3.0	5.3	6.6	5.3
Spain	3.7	3.3	5.3	8.0	11.8
France	4.3	7.5	9.7	11.4	11.6
Ireland	18.8	19.7	33.1	41.1	45.2
Italy	3.7	6.8	9.6	9.6	11.9
Netherlands	20.8	26.5	32.9	34.8	32.2
Austria	10.1*	11.1	13.5	17.9	15.5
Portugal	4.5	7.1	10.6	19.7	17.4
Finland	10.7*	13.5	15.8	11.9	18.0
Sweden	10.9*	12.2	14.4	15.5	20.5
United Kingdom	3.3	6.1	10.6	10.9	12.1
EU-12 (excl. AT, SE and FI)	6.0	9.9	13.4	14.7+	14.4#
EU-15	7.8*	10.1	13.5	14.7+	14.6'

* 1963
+ including West Germany
# including East and West Germany
Source: European Commission (1996)

Table 3: Exports of goods by EU countries to non-EU countries (as a percentage of GDP, current prices)

country of origin:	1960	1970	1980	1990	1995
Belgium/Luxembourg	12.7	9.6	12.3	12.5	14.6
Denmark	10.6	7.4	8.2	9.5	10.9
(West) Germany	9.5	7.5	9.3	9.5'	9.0"
Greece	2.7	2.3	5.3	3.1	3.9
Spain	2.6	3.0	4.5	3.2	4.5
France	6.9	4.9	7.0	6.1	6.7
Ireland	4.5	5.0	9.1	11.6	16.2
Italy	5.5	5.5	7.6	5.8	9.2
Netherlands	13.2	8.1	9.9	11.4	12.6
Austria	6.5*	8.6	9.2	8.5	8.3
Portugal	7.1	6.4	5.6	4.7	4.3
Finland	6.5*	7.7	11.6	7.9	13.7
Sweden	6.7*	8.0	10.0	9.4	14.7
United Kingdom	11.0	9.5	10.7	8.1	9.1
EU-12 (excl. AT, SE and FI)	8.7	6.8	8.5	7.5+	8.9
EU-15	6.1*	6.9	8.6	7.6+	8.9"

* 1963
+ including West Germany
" including East and West Germany
Source: European Commission (1996)

Table 4: Inside EU goods trade versus outside EU goods trade as a percentage of GDP, market prices (EU-12)

	inside EU exports	outside EU exports	inside EU imports	outside EU imports
1960	6.0	8.7	6.0	9.8
1965	8.0	6.1	8.0	7.8
1970	9.9	6.8	9.9	8.0
1975	11.6	8.2	11.4	9.4
1980	13.4	8.5	13.1	11.3
1985	15.1	10.0	14.8	10.9
1990	14.7	7.5	14.6	8.5
1995	14.4	8.6	13.3	8.6

Source: European Commission (1996)

b) Foreign direct investment

Globalization theory could still be defended against our above argument by saying that the process of globalization is not adequately measured by foreign trade figures. The core of the globalization process might be argued to be the movement of capital rather than of exported goods across the globe. Instead of exporting goods, one builds factories. In principle, this process could even be accompanied by decreasing export and import figures, while the international dependency of economies may increase. We shall examine this proposition below by examining data about foreign direct investment of European countries.

Systematic figures on the development of foreign direct investment are sparse. We found information on Germany (from the *Monatsberichte der* ***Deutschen Bundesbank),*** on Great 'Britain (from the *Office of* National *Statistics)* and for the Netherlands (from the Annual Report of the Central Bank, *DNB*). Moreover, the OECD published data on France.' These data are shown in Tables 5-8.

[1] The various issues of the ***OECD Review of Foreign Direct Investment*** are far from complete. In addition to the data on France, we found less systematic pieces of information on smaller EU countries which seem to confirm that the poorer countries (often referred to as 'non-OECD') play a minor role. For example, Finland directed 11% of its FDI to non-OECD countries during 1982-87 and 10.4% during 1988-94. In Denmark, the corresponding per-

Table 5 Foreign direct investment of UK companies by World regions

	total FDI of UK; billion pounds; current prices	percentages of which were directed to: EU and Western Europe	Non-Europe-an Developed countries	Rest of World	of which: developing countries'	of which Asia@
1987	19 159	15.3%	74.5%	10.1%	10.1%	2.4%
1988	20 916	27.3%	63.4%	8.4%	8.3%	2.3%
1989	21491	26.1%	63.2%	10.6%	10.6%	2.6%
1990	10 108	57.4%	20.6%	22.0%	21.5%	6.5%
1991	9304	42.6%	41.4%	16.0%	15.8%	9.2%
1992	10 107	48.3 %	23.7%	28.0%	27.7%	9.4%
1993	16 859	36.3%	50.3%	13.5%	13.2%	9.8%
1994	18 514	36.3 %	40.6%	23.1%	21.4%	9.9%

@ excluding Japan
# excluding Eastern Europe

centages are 5.8% (1985-92) and 11% in 1993, and in Portugal 12% during 1986-92. However, other countries show somewhat higher percentages. The share of non-OECD countries in Italy's FDI was 27.6% in (1982-96) and 32.3% in 1987-92. In Switzerland, the corresponding figure for 1994 is 21.2 % and for Norway we found the figures of 43.5 % for 1986 and 19.6% in 1993. Whether the latter three cases give support to globalization theory remains doubtful. A good judgment would require data over longer time periods, since FDI figures (as all investment figures) tend to show strong variations over time.

Table 6 Foreign direct investment of German companies by World regions

	total German FDI; billion DM; current prices	percentages of which were directed to: EU- 12 countries	other industrialized countries	Develop. and transition countries	of which: 4 Asian tigers[#]
1979	69.5	39.6%	37.3%	23.2%	0.9%
1981	101.2	36.0%	38.5%	23.3%	1.2%
1987	150.9	40.8%	46.3%	12.9%	2.2%
1989	205.6	43.7%	45.2%	11.1%	2.3%
1991	262.7	51.0%	38.3%	10.7%	2.2%
1993	319.4	48.0%	39.5%	12.6%	2.4%

[#] HongKong, Singapore, South Korea, Taiwan

Table 7 Foreign direct investment of French companies by World regions

	total French FDI; billion Francs; current prices	of which were directed to: EU-12 countries	other Europe	USA and Canada	other OECD countries	non-OECD countries
1986	32 115	33.5%	7.6%	44.8%	2.6%	11.5%
1987	49 012	53.9%	4.7%	33.4%	1.7%	6.3%
1988	73 018	‘63.5%	5.8%	25.4%	1.2%	4.1%
1989	109 521	62.2%	4.2%	26.6%	2.1%	5.0%
1990	142 813	67.9%	5.3%	22.6%	1.0%	3.2%
1991	108 531	53.0%	11.2%	28.6%	1.0%	6.2%
1992	92 408	80.0%	2.3%	7.9%	1.7%	7.1%
1993	52 289	55.3%	4.4%	14.2%	1.9%	24.2%
1994	51483	54.8%	-2.2%	30.0%	2.6%	14.8%
1980-85	16 398	29.7%	6.3%	48.3%	2.3%	11.6%
1986-94	79 021	61.2%	5.2%	24.1%	1.6%	7.9%

Table 8 Foreign direct investment of Dutch companies by World regions

	total FDI billion Guilders; current prices	percentages of which were directed to: EU-12 countries	USA	Japan	Eastern Europe	Developing countries	of which: S.E. Asia*
1977	3,815	46.1%	13.2%	0.1%		32.2%	
1978	5,596	49.2%	28.5%	0.3%		16.8%	
1979	6,519	57.4%	28.8%	0.0%		6.8%	
1980	7,803	58.1%	22.1%	0.2%		10.9%	
1981	9,114	56.5 %	21.4%	0.2%		10.2%	
1982	7,015	49.7%	35.2%	0.0%		9.3%	
1983	6,027	60.4%	28.6%	1.5%		7.7%	
1984	8,172	68.6%	17.1%	0.7%		8.7%	
1985	9,461	36.4%	36.8%	1.9%		24.6%	
1986	7,401	70.5 %	20.5%	-0.7%	-0.2%	4.7%	1.6%
1987	14,086	42.4%	48.1%	0.2%	-0.04%	4.6%	0.8%
1988	8,741	29.0%	34.5%	1.4%	0.1%	18.7%	2.9%
1989	24,120	51.8%	30.4%	0.2%	0.1%	11.1%	5.2%
1990	24,742	57.9%	22.7%	1,.5%	0.05 %	9.9%	2.3%
1991	23,046	67.5 %	14.7%	1.6%	1.3%	9.3%	5.7%
1992	24,953	62.1%	23.3%	-0.1	3.2%	5.4%	1.6%
1993	19,312	77.4%	11.6%	-14.5	5.3%	10.9%	3.2%
1994	21,677	74.1%	0.5%	-0.3	3.4%	-	9.5%
1995	19,952	57.9%	11.7%	4.0%	10.1%	-	5.5%

* China, Philippines, HongKong, Indonesia, Malaysia, Singapore, Taiwan, Thailand and South Korea.

The above tables show a quite diverse picture, and inferences about time trends need to be drawn with caution since the series are short and erratic. The French and German figures show a substantial increase of foreign direct investment from the 1980s to the present which, in principle, is what globalization theorists would expect. This does not hold for the UK and The Netherlands, however, where the FDI figures are more or less stagnant.

For a judgement about globalization theory not only the development of total FDI but also its destination is important. Globalization theory implies that a growing share of FDI is world-wide in scope, and that low-wage countries in particular should attract increasing shares. This is clearly not the case. The only exception could be the share of British FDI in underdeveloped countries which showed a slight increase from 1987 to 1994. Given the short observation period and the erratic nature of investment data, however, we have to be cautious with this conclusion. The French and Dutch data do not show an increasing share of underdeveloped (or in the French

case: non-OECD) countries in total FDI, while the German data reveal even a clearly declining share of 'developing and transition countries' in the growing volume of FDI.

The lion's share of German FDI is directed towards EU countries and seems even to grow over time. It might be debated whether the French and UK data show a similar trend towards growing European shares of their FDI or whether these shares remain more or less unchanged. In any case, we can conclude that the shares of French and British FDI directed to countries *outside* the EU are not increasing, and this also applies to the Netherlands. Again, this is inconsistent with the globalization theory.

In conclusion, evidence from export figures and from FDI data are largely in conflict with the globalization theory. Exports by EU countries (as a percentage of GNP) to non-EU countries have almost stagnated since the 1960s, while the corresponding percentage of intra-EU trade has doubled. We could still debate whether an increasing European scope also holds for FDI. This is certainly the case for Germany; in the French, British and Dutch cases, the trend towards 'Europeanization' of FDI is less pronounced, but the figures do not show a trend towards increasing 'mondialization' or 'globalization'. We conclude that export and FDI figures show little evidence of any increasing integration between the European trade bloc and the World's other trade blocs.

Our observation that structural change goes in the direction of increasing 'Europeanization' rather than 'globalization' is consistent with the conclusion reached by Ruigrok & Van Tulder (1995). In an analysis of the structure of large multinationals, these authors conclude that even companies that operate world-wide still focus strongly on their home countries. Moreover, Pate1 & Pavitt (1991) consider their own analysis of the technological strategies of the World's largest firms to be "an important case of non-globalization" (subtitle).

Critics may argue that quite large streams of speculative capital exist in money markets and stock exchanges which may be 'global' in scope and which we did not consider in our above Tables. In addition, we have not examined the hypothesis of increasing convergence of factor prices on a world scale. This would certainly provide material for another paper. In the meantime, globalization theorists should be concerned about non-globalization patterns in at least three important areas: (1) international trade, (2) foreign direct investment, and (3) technological strategies of multinational firms which require explanation.

III Possible explanations of the non-globalization process

The notion that 'footloose' capital will move around the globe to those places where profit opportunities are most favourable suggests that, due to a possible combination of Western technology with extremely low wages, low-wage countries should be in a strong position when competing for foreign investors. Their ability to attract foreign investment should be further enhanced by recent advances in information and communication technology which make the management of world-wide operations ('global sourcing') even more cheap and efficient. Why, then, are transactions with low-wage countries still of such modest importance to the rich countries?

There are pieces of knowledge from innovation research which suggest that knowledge-intensive business is not as footloose as one might expect from an orthodox neo-classical view. An important argument relates to so-called 'tacit' knowledge. It has been suggested that, in addition to formalised, well-documented and tradable knowledge, 'tacit' knowledge plays an important role in innovative activities. Tacit knowledge is based on practical experience with certain technologies. It has also been characterised as 'implicit', 'idiosyncratic' or 'uncodified' knowledge which is not available in textbooks or training courses, although it may be transferred from person to person (Dosi 1988).

These properties of 'tacitness' have a number of implications for firm behaviour, one of which is significant in the context of this paper: the transfer of tacit knowledge requires personal contact and physical proximity. Nooteboom (1996) suggests that, notably in the early stages of development of new technologies, tacitness may be important, while technologies in a riper stage will increasingly be characterised by knowledge that is more formalised, better documented and more easily transferable across geographical distance.

This latter point would explain why new innovative industries concentrate in Marshallian 'industrial districts'. Neo-Schumpeterian (or evolutionary) theorists stress the crucial role of variety for innovative activities within such industrial districts; in other words, networking interactions in close geographic space of firms and persons with different types of 'idosyncratic' tacit knowledge may promote innovation (cf. Nooteboom 1992). Such arguments about tacit knowledge may explain why, for innovative business, local or regional embeddedness is more important than the factor price differentials that are so important in traditional neoclassical thinking and which can lead one to believe in 'globalization'. Arguments in favour of regional embeddedness are supported by empirical evidence that, due to knowledge spillovers, agglomerated regions in highly developed countries are better 'breeding places' for innovation than are rural areas (see for the US: Jaffee 1986 and Feldman 1994; for the Netherlands see: Brouwer & Kleinknecht 1996).

An additional argument in this context is that 'high tech' often requires 'high touch'. For instance, repair and maintenance services (e.g. the mastering of machine breakdowns) often can-

not be performed through a satellite connection. They require the physical presence of specialists; moreover, in communication about subtle technical details, language barriers and cultural differences can be important thresholds. Adherents of modem endogenous growth theory would add that, besides cultural differences, the most important threshold for the diffusion of modem technology in low wage countries is the notorious lack of qualified labour. Obviously, other arguments could be added, such as the quality of the public infrastructure and public services (political stability, corruption, etc.).

Such arguments make it understandable why, in spite of impressive differences in factor prices (and notably in wages), industry is much less 'footloose' than might be expected from simple versions of neo-classical theory. Even neo-classical economists should be reluctant to believe that Asian 'tigers' will be able to combine highly productive labour (using modem Western technology) with extremely low wages, simply because wages tend to equal marginal productivity. Moreover, Paul Krugman (1996) has recently convincingly criticised the notion of competition between countries. He also pointed out that the popular fear that Asian tigers would destroy our employment and welfare by producing tremendous export surpluses and, at the same time, by becoming net importers of capital, is to be ascribed to lack of knowledge of the basics of international trade theory.

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